2020 Ontario Budget

Whittling Down the Sizeable Deficit

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November 6, 2020

Highlights

- The government's first full budget since the COVID-19 outbreak reveals a record $38.5 billion shortfall this fiscal year – identical to the August estimate – followed by some modest deficit reduction over the next few years.
- Policymakers introduced $15 billion worth of new COVID-19 support measures in the budget, though a large share is unallocated and budgeted for future years.
- Net debt-to-GDP is projected to rise from 47.0% this fiscal year to 49.6% by FY 2022/23, thanks to lingering deficits and increased capital spending. Record low interest rates will downwardly pressure debt servicing costs, although they too are expected to rise over the projection horizon.
- Projected budget paths outlined in today's document highlight the challenging fiscal road ahead as the pandemic leaves an indelible legacy. Tough decisions will likely be required once the economy is on a sounder footing.

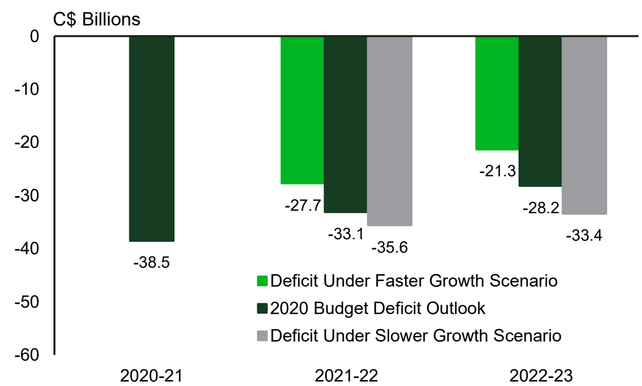
In its first full budget since the onset of the pandemic, the Ontario government unveiled a three-pillar action plan meant to cushion the blow from COVID-19 and support the nascent economic recovery. To this end, policymakers have set aside a notable $15 billion in new spending and tax reduction commitments over three years. However, much of this funding remains unallocated, suggesting the government is leaving some of its powder dry.

This year's deficit is projected at $38.5 billion – the same as in the August fiscal update. This represents about 4.5% of GDP, trailing only Alberta and Newfoundland and Labrador by this measure. And, these are two provinces which have been ravaged by low oil prices in addition to the pandemic.

For the first time since onset of COVID-19, the province has provided a road map for where the deficit will head after this fiscal year. The assumption of continued economic recovery alongside reduced program spending allows the deficit to creep lower over the three-year horizon in the government's baseline economic scenario, ending FY 2022/23 at $28.2 billion. In contrast, net debt to GDP is set to climb further from its current 47.0% level over the three-year horizon, lifted in part by rising infrastructure expenditures.

In terms of notable policy changes, the government pledged tax and electricity rate relief for businesses, a new tax credit for seniors, and investments in broadband and cellular services to support the recovery.

Chart 1: Province to Make Some Headway Towards Reducing the Deficit



Source: Ontario Budget 2020, TD Economics

Pandemic Uncertainty Gives Rise To Different Economic Projections

In its plan, the government highlighted three economic scenarios reflecting the unusually high level of uncertainty during the pandemic. However, the government does not elaborate on what assumptions underpin the different growth paths in each scenario.

In the scenario that the government uses for its fiscal planning, real and nominal GDP decline sharply this year, owing to the damage wrought by the pandemic. A solid recovery is forecast for 2021 before growth slows in 2022 and 2023. Comparing this scenario to our own forecasts, we are considerably less pessimistic on the magnitude of contraction in 2020 but anticipate a softer rebound next year (followed by nearly the same growth in 2022). The net result is similar levels of GDP being achieved by 2022 in both forecasts.

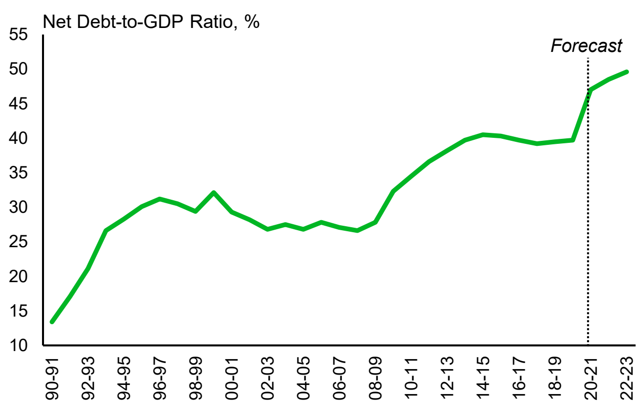
In the government's slower growth scenario, real GDP posts a weak rebound in 2021 and decelerates thereafter, leaving output well below pre-pandemic levels by 2023. In contrast, the faster growth scenario projects a very strong rebound next year followed by solid growth.

Each of these scenarios have implications for deficit projections. However, under each scenario, the deficit improves from its current position thanks to a pull-back in program spending from this year's peak level.

Steep Drop In Revenues Projected For This Fiscal Year

Budget 2020 announces tax relief for businesses and households including:

Chart 2: Lingering Deficits, Rising Capital Investment to Push Net Debt-to-GDP Higher



Source: Ontario Budget 2020, TD Economics.

Government of Ontario Fiscal Plan [C$ billions unless otherwise noted]				
	2020 Budget Plan			
Fiscal Year	19-20	20-21	21-22	22-23
Revenues	156.1	151.1	152.3	160.2
% change	3.5	-3.2	0.8	5.2
Expenditures	164.8	187.0	183.4	186.3
% change	1.4	13.5	-1.9	1.6
Reserve	-	2.5	2.0	2.0
Budget Balance	-8.7	-38.5	-33.1	-28.2
Net Debt	353.3	398.0	437.8	472.9
% of GDP	39.7	47.0	48.5	49.6

Note : Numbers may not add up due to rounding.
Source: Ontario Ministry of Finance, as at November 2020

- Reducing the employer health tax by making payroll exemptions permanent.
- Introducing a new Seniors Home Safety Tax Credit, meant to assist seniors living in their homes with improvements to make their homes safer and more accessible.
- Lowering property taxes for employers by reducing business education tax rates and by providing municipalities with the flexibility to lower taxes for small businesses, with the option to match the reductions at the provincial level.

The Ontario government is forecasting a sharp 3.2% drop in revenues this fiscal year. While undoubtedly a severe decline, we note that the Province has seen even steeper drops historically (in the Global Financial Crisis, for example). Healthy growth in federal transfers is expected to provide an important offset to weak own-source revenue growth this fiscal year.

After this year, revenues edge slightly higher in FY 2021/22, weighed on by new tax relief announcements and a drop in federal transfers, before jumping higher by FY 2022/23 on gains in nearly every major revenue category.

Government Beefs Up COVID-19 Support Spending

As noted, the government has set aside an additional $15 billion over the next three fiscal years to protect against COVID-19 and buttress the recovery. Combining these announcements with past measures yields a total of $45 billion on pandemic-support measures through FY 2022/23.

Ontario Economic Assumptions Under Various Scenarios [Percent change unless otherwise noted]					
	2019	2020F	2021F	2022F	2023F
Real GDP (Planning Scenario)	1.7	-6.5	4.9	3.5	2.0
Nominal GDP (Planning Scenario)	3.9	-5.0	6.6	5.7	4.2
Real GDP (Slower Growth Scenario)	1.7	-6.5	3.3	1.0	1.4
Real GDP (Faster Growth Scenario)	1.7	-6.5	7.5	3.1	2.3
Source: Ontario Ministry of Finance, as at November 2020					

This represents a little over 1.5% of GDP, annually. Despite these commitments, it's clear that the government wants to leave ample room in its war chest to respond to future COVID-19 pressures, as nearly $8 billion of new funding is currently unallocated and budgeted to be spent over the next two fiscal years.

Outside of these rainy-day allocations, new spending commitments include:

- Outlays to increase the amount of direct care provided to residents in long-term care facilities.
- Making investments of over $680 million over the next four years on broadband infrastructure.
- Spending $1.3 billion on lowering electricity bills for industrial and commercial employers.

Overall, program spending program spending is set to increase by a hefty 15% in FY 2020/21, fueled by a huge gain in "other programs", which captures many of the new spending commitments (e.g. top-up of pandemic funds, broadband investment, electricity rate relief). As for other big-ticket items, relatively subdued gains of about 1.5%-2.5% are expected in healthcare and education spending this fiscal year.

After this fiscal year, program spending growth is projected to gear down considerably, averaging a 0.6% decline through FY 2022/23. Still spending is projected to be considerably higher than pre-pandemic levels over the projection horizon.

Net Debt to GDP to Climb Higher

Even with the expectation of a reasonably robust economic recovery, net debt to GDP is forecast to increase from 47.0% this fiscal year to 49.6% by FY 2022/23. Net debt is pushed higher by lingering deficits and increased capital investment. After the pandemic, the government's goal will be to slow the rate of growth in the net debt-to-GDP ratio. Importantly, the government plans on setting a long-term target for net debt-to-GDP along with a path back to balance in the 2021 budget.

The elevated stock of debt leads to rising debt servicing charges through FY 2022/23, despite record low borrowing rates. As a share of revenue, debt service costs drift higher over the next few years, but remain below recent peaks.

The province's overall funding requirement is expected to rise from $39.5 billion in FY 2019/20 to $52.3 billion this fiscal year. A further increase to $59.3 billion is anticipated by FY 2022/23, in part owing to an increase in maturities.

Bottom Line

Ontario is the first among the 'Big Four' Provinces to provide a medium-term fiscal roadmap since the onset of the pandemic. In addition to this multi-year window, we welcome the government's choice to lay out more than one economic scenario, since it reflects the reality of an extremely uncertain backdrop. Given the inclusion of a "faster growth" scenario, today's budget serves as a reminder than not all risks on are on the downside.

Projected budget paths outlined in today's document highlight the challenging fiscal road ahead as the pandemic leaves an indelible legacy. Ontario had a worse starting position heading into the pandemic, in terms of net debt to GDP, than most other provinces and the burden is projected to worsen over the forecast horizon. Low interest rates should keep debt servicing charges contained, even if they aren't projected to fall like they are at the federal level. Still, tough decisions will likely be required once the economy is on a sounder footing.